

**RECONSIDERATION EVALUATION OF THE CERTIFICATE OF NEED APPLICATION
SUBMITTED ON BEHALF OF SURGERY CENTER OF SILVERDALE, LLC PROPOSING TO
ESTABLISH AN AMBULATORY SURGERY CENTER IN KITSAP COUNTY**

PROJECT DESCRIPTION

On March 3, 2005, Surgery Center of Silverdale, LLC was established as a limited liability company licensed in the state of Washington. On June 24, 2005, Surgery Center of Silverdale, LLC (SCS, LLC) submitted its Certificate of Need application to establish an ambulatory surgery center to serve the residents of Kitsap County, and surrounding areas. Within the March 3, 2005, LLC documents, SCS, LLC consisted of five physicians, each with at least 10% or greater membership interest in the LLC. [source: Initial Application, p5; Secretary of State website; and October 17, 2005, Business Risk Assessment provided by the Office of Financial Recovery]

On December 29, 2005, SCS, LLC submitted an application to amend its initial application that was submitted on June 24, 2005. Within the amended application, the membership of SCS, LLC was modified from the five-physician ownership described above to 70% Kitsap Outpatient Surgery, LLC¹ and 30% Harrison Medical Center, an acute care hospital located in the city of Bremerton, within Kitsap County. Below is a brief description of the owning entities of SCS, LLC. [source: Amended Application, pp5 & 10]

Surgery Center of Silverdale, LLC

Owning Entity	Percentage Owned
Kitsap Outpatient Surgery, LLC	70%
Harrison Medical Center	30%

Kitsap Outpatient Surgery, LLC -- 70% ownership of SCS, LLC

Owning Entity	Percentage Owned
Jason Cheun, MD	20%
Eric Cole, MD	20%
Todd Schneiderman, MD	20%
John Kerrigan, MD	20%
Blake Reiter, MD	20%

Harrison Medical Center, Bremerton -- 30% ownership of SCS, LLC

Harrison Medical Center (HMC), located in the city of Bremerton within Kitsap County, is currently a provider of Medicare and Medicaid acute care services to the residents of Kitsap County and surrounding communities, including portions of Jefferson, Mason, and Clallam counties. HMC currently operates 297 acute care beds on two campuses in Kitsap County: Bremerton Campus and Silverdale Campus. The Bremerton campus is located at 2520 Cherry Avenue in the city of Bremerton; and the Silverdale campus is located at 1800 Northwest Myhre Road in the city of Silverdale. HMC is a Washington State level III trauma center and holds a three-year accreditation from the Joint Commission on Accreditation of Health Care Organizations. [source: CN historical files, Secretary of State]

¹ Kitsap Outpatient Surgery, LLC was established on December 8, 2005.

website, and data obtained from the department's Office of Emergency Medical and & Trauma Systems]

For this project, SCS, LLC proposes to establish a new ASC to be known as Surgery Center of Silverdale. The ASC would be located in the Clear Creek Professional Building at 9800 Levin Road, Suite 102, in the city of Silverdale, within Kitsap County. The ASC would have two operating rooms (ORs), pre- and post-operating space, procedure rooms and support/staff areas. If approved, services immediately offered at the ASC would be ophthalmology--including retinal, plastic, and pediatric--and general surgery. Once the facility becomes operational, SCS, LLC anticipates recruitment of specialists in ENT and podiatry. [source: Amended Application, pp6-8 & pp45-46]

If this project is approved, SCS, LLC anticipates commencement of the project immediately, and completion within twelve months. Under this timeline, the ASC would become operational in mid year 2007, and year 2008 would be the facility's first full calendar year of operation. [source: Amended Application, p17]

The estimated capital expenditure for this project is \$1,510,884. Of that amount, 69% is related to equipment (both fixed and moveable); 14% is related to fees; 11% is related to tenant improvements of the site; and the remaining 6% is related to startup and financing costs. [source: February 13, 2006, supplemental information, Appendix AAS-2]

BACKGROUND INFORMATION ON THE PROJECT

On July 7, 2006, the department released its evaluation regarding SCS, LLC's proposal to establish an ASC in Kitsap County. The July 7, 2006, evaluation identified two terms and a condition that SCS, LLC had to agree to meet before a certificate could be issued. On July 11, SCS, LLC submitted their agreement to the terms and condition, therefore on July 14, 2006, Certificate of Need (CN) #1334 was issued to SCS, LLC.

On August 4, 2006, Olympia Ambulatory Surgery Center, an affected person to the project, submitted its "Request for Reconsideration" related to the department's issuance of CN #1334.² The department granted Olympia Ambulatory Surgery Center's reconsideration request, and on October 25, 2006, conducted a public hearing and received additional information from SCS, LLC and the affected person, Olympia Ambulatory Surgery Center. On November 9, 2006, both SCS, LLC and Olympia Ambulatory Surgery Center submitted rebuttal comments related to any comments received at the public hearing. This document is the evaluation of the reconsideration information.

APPLICABILITY OF CERTIFICATE OF NEED LAW

This project is subject to Certificate of Need review as the establishment of a new health care facility under the provisions of Revised Code of Washington (RCW) 70.38.105(4)(a) and Washington Administrative Code (WAC) 246-310-020(1)(a).

² WAC 246-310-560.

APPLICATION CHRONOLOGY

March 3, 2005	Letter of Intent Submitted
June 24, 2005	Initial Application Submitted
June 25, 2005, through December 28, 2005	Department's Pre-Review Activities <ul style="list-style-type: none">• 1st screening activities and responses• 2nd screening activities and responses
December 29, 2005	Amendment Application Submitted
December 30, 2005 through February 26, 2006	Department's Pre-Review Activities <ul style="list-style-type: none">• 1st screening activities and responses• 2nd screening activities and responses
February 27, 2006	Department Begins Review of Application
April 19, 2006	Public Hearing Conducted/End of Public Comment
May 4, 2006	Rebuttal Documents Received at Department
June 19, 2006	Department's Anticipated Decision Date
July 19, 2006	Department's Revised Decision Date ³
July 7, 2006	Department's Actual Decision Date

Reconsideration Review

August 4, 2006	Olympia Ambulatory Surgery Center Submits Request for Reconsideration, including supplemental documentation
September 5, 2006	Department Grants Reconsideration
October 25, 2006	Reconsideration Public Hearing Conducted in Silverdale
	Information Submitted by Applicant & Affected Person
November 9, 2006	Rebuttal Documents Received at Department
December 26, 2006	Department's Anticipated Reconsideration Decision Date
December 26, 2006	Department's Actual Reconsideration Decision Date

AFFECTED PERSONS

Throughout the initial review of this project, one entity--Olympic Ambulatory Surgery Center--sought and received affected person status under WAC 246-310-010. Olympic Ambulatory Surgery Center is a CN approved ASC located at 2613 Wheaton Way in the city of Bremerton, within Kitsap County. During the reconsideration review of the SCS, LLC application, Olympic Ambulatory Surgery Center submitted comments regarding this reconsideration review.

SOURCE INFORMATION REVIEWED-INITIAL

- Surgery Center of Silverdale, LLC's Initial Certificate of Need Application received June 24, 2005
- Surgery Center of Silverdale, LLC's supplemental information dated September 29, 2005, and November 4, 2005
- Surgery Center of Silverdale, LLC's Amended Certificate of Need Application received December 29, 2005

³ The department requested an extension to the decision date to July 19, 2006. The applicant concurred with the extension on June 26, 2006.

SOURCE INFORMATION REVIEWED-INITIAL (continued)

- Surgery Center of Silverdale, LLC's supplemental information dated February 9, 2006 and February 15, 2006
- Public comment received throughout the review of the application
- Public hearing documents received at the April 19, 2006, public hearing
- Surgery Center of Silverdale, LLC's rebuttal comments received May 4, 2006
- Olympic Ambulatory Surgery Center's rebuttal comments received May 4, 2006
- Kitsap County ASC and/or operating room utilization survey responses
- Historical charity care data obtained from the Department of Health's Office of Hospital and Patient Data Systems (2002, 2003, and 2004 summaries)
- Population data obtained from the Office Financial Management based on year 2000 census published January 2002
- Licensing and/or survey data provided by the Department of Health's Office of Health Care Survey
- Business Risk Assessment provided by the Office of Financial Recovery dated October 17, 2005
- Comprehensive Hospital Abstract Reporting System (CHARS) data obtained from the Department of Health's Office of Hospital and Patient Data Systems
- Trauma designation data for Harrison Medical Center provided by the Department of Health's Office of Emergency Medical and Trauma Systems
- Data obtained from the Internet regarding mileage and distance
- Data obtained from the Internet regarding HealthSouth
- Certificate of Need Historical files

ADDITIONAL SOURCE INFORMATION REVIEWED--RECONSIDERATION

- Olympic Ambulatory Surgery Center's Request for Reconsideration received August 4, 2006
- Surgery Center of Silverdale's August 22, 2006, response to Olympic Ambulatory Surgery Center's Request for Reconsideration
- Surgery Center of Silverdale's information submitted at the October 25, 2006, reconsideration public hearing
- Olympic Ambulatory Surgery Center's information submitted at the October 25, 2006, reconsideration public hearing
- Surgery Center of Silverdale's rebuttal comments received November 9, 2006
- Olympic Ambulatory Surgery Center's rebuttal comments received November 9, 2006

CRITERIA EVALUATION

To obtain Certificate of Need approval, the applicant must demonstrate compliance with the criteria found in WAC 246-310-210 (need); 246-310-220 (financial feasibility); 246-310-230 (structure and process of care); 246-310-240 (cost containment) and WAC 246-310-270 (ambulatory surgery).⁴

⁴ Each criterion contains certain sub-criteria. The following sub-criteria are not relevant to this project: WAC 246-310-210(3), (4), (5), and (6).

In its July 7, 2006, initial evaluation, the department concluded that SCS, LLC's project met the criteria under WAC 246-310-210 (need); WAC 246-310-220 (financial feasibility); 246-310-230 (structure and process of care); and 246-310-240 (cost containment), provided that SCS, LLC agree to two terms and a condition. As previously stated, SCS, LLC agreed to the terms and condition, and on July 14, 2006, CN #1334 was issued for the project.

In its August 4, 2006, reconsideration request, Olympic Ambulatory Surgery Center identified specific grounds for reconsideration. This reconsideration evaluation will address the specific grounds identified in Olympic Ambulatory Surgery Center's request.

CONCLUSION

For the reasons stated in this evaluation, Surgery Center of Silverdale, LLC continues to meet the applicable review criteria to establish an ambulatory surgery center in the city of Silverdale within Kitsap County. As a result, Certificate of Need #1334 issued on July 14, 2006, remains valid.

A. Need (WAC 246-310-210)

Based on the source information reviewed, the department determines that the applicant has met the need criteria in WAC 246-310-210.

- (1) *The population served or to be served has need for the project and other services and facilities of the type proposed are not or will not be sufficiently available or accessible to meet that need.*

Initial Evaluation Summary

Within its initial evaluation, the department concluded that SCS, LLC provided documentation to support that this review criterion was met. [source: Initial evaluation, pp5-10]

Reconsideration Evaluation

Within its reconsideration request, Olympic Ambulatory Surgery Center (OASC) provided the following five assertions to support its overarching assertion that the department should reconsider its approval of SCS, LLC's application. [source: OASC reconsideration request received August 4, 2006, pp4-18]

- The department failed to follow established regulatory procedures for calculating need.
- The department failed to follow its own decision to exclude certain information related to HealthSouth from consideration.
- Significant relevant information was not previously considered by the department.
- Significant changes have occurred in factors and circumstances relied upon by the department in its decision.
- Other good cause exists to warrant reconsideration.

In this reconsideration evaluation, the department will identify each of the five assertions submitted by OASC, summarize OASC's concerns under each assertion, summarize SCS, LLC's responses to each assertion, and then provide its reconsideration evaluation

- **The department failed to follow established regulatory procedures for calculating need.**

[source: OASC, August 4, 2006, reconsideration request, pp4-9]

OASC asserts there are three specific factors used in the department's numeric methodology that are incorrect. The three factors are 1) Inventory of existing mixed use and dedicated outpatient ORs in Kitsap County; 2) Calculation of the average surgical minutes; and 3) Exclusion of CN Exempt ORs in Kitsap County when counting OR capacity in the county. SCS, LLC also submitted comments regarding the three factors.

- 1) **Inventory of existing mixed use and dedicated outpatient ORs in Kitsap County.**

OASC

Specifically, OASC has two issues related to the OR inventory. The first issue centers on the number of mixed-use ORs reported by Harrison Medical Center (30% owner of SCS, LLC). OASC argues that the hospital provided three separate and inconsistent inventory/survey documents during the course of reviewing this application. The documents were provided in June 2005, November 2005, and February 2006, and all three documents reported a different number of ORs for

Harrison Medical Center--12 mixed use ORs; 14 mixed-use ORs; and 10 mixed use ORs, respectively. Given that the department relied on one of the hospital's inventory documents in its methodology, OASC asserts that the methodology is incorrect.

OASC's second issue centers on the count of dedicated outpatient ORs in the county. On November 17, 2005, OASC provided its own inventory/survey document. In that document, OASC identified that it had two "*active dedicated outpatient*" ORs and two ORs "*closed/not in use.*" On the basis of that document, the department counted the two active dedicated outpatient ORs in the inventory of ORs within the methodology. OASC asserts that the two closed ORs should be counted in the Kitsap County OR inventory. It is noted that OASC provided a revised OR inventory document within its November 9, 2006, rebuttal documents. The revised inventory document identifies 4 "active dedicated outpatient ORs" even though OASC has consistently asserted throughout this review that 2 of its 4 four ORs are closed and not in use.

SCS, LLC

Within its reconsideration public hearing documents and its rebuttal documents, SCS, LLC provided an extensive explanation for the three different inventory documents for Harrison Medical Center. The February 2006 inventory is identified by SCS, LLC as the correct inventory--10 mixed-use ORs at Harrison Medical Center. [source: October 25, 2006, public hearing documents, pp2-5; November 9, 2006, rebuttal documents, pp3-5]

Regarding the number of dedicated outpatient ORs in the county, SCS, LLC asserts that the methodology was applied correctly using the 2 active rooms at OASC. The numeric methodology concluded a need for 6 outpatient ORs in year 2010. [source: October 25, 2006, public hearing documents, pp5-6; November 9, 2006, rebuttal documents, pp1-3]

DEPARTMENT'S RECONSIDERATION EVALUATION

Initially, concerns regarding three different inventory documents within an application is valid in any review. However, for clarification purposes, the June 2005 document identifying 12 ORs was not provided by the hospital--it was provided by SCS, LLC before the hospital became a partner in the project.⁵ At that time, SCS, LLC believed the hospital had 12 ORs and used that number within its application. Therefore, this error cannot be attributed to the hospital. Regarding the November 2005 identification of 14 ORs submitted in the amended application, SCS, LLC states that hospital staff inadvertently included two dedicated heart surgery rooms and two procedure rooms in its OR inventory--for a total of 14 ORs. The error was not found until after the document was included in the amended application. The correct count of mixed use ORs at Harrison Medical Center is 10.

⁵ SCS, LLC's initial application was submitted on June 25, 2005. At that time, Harrison Medical Center was not a partner in the project. On December 29, 2005, (six months after the first submission), the hospital joined as a partner and SCS, LLC appropriately submitted an amended application as required under WAC 246-310-100(f).

This is the number used by the department when applying the numeric methodology.

2) **Calculation of the average surgical minutes.**

OASC

OASC points out an error in the department's numeric methodology related to Harrison Medical Center's information. Specifically, the department calculated the hospital's average surgery minutes by dividing 2005 outpatient surgery minutes by its 2004 count of outpatient surgeries. OASC asserts that year 2005 data should have been used.

SCS, LLC

SCS, LLC agrees that an error was made in the department's application of the numeric methodology and asserts that year 2004 data, rather than 2005 data should have been used for the hospital.

DEPARTMENT'S RECONSIDERATION EVALUATION

Both OASC and SCS, LLC identified the same error in the department's numeric methodology, however, OASC and SCS, LLC do not agree on which year's data that should be used. The department acknowledges that an error was made.

The methodology estimates OR need in a planning area using multi-steps as defined in WAC 246-310-270(9). This methodology relies on a variety of assumptions and initially determines existing capacity of dedicated outpatient and mixed-use operating rooms in the planning area, subtracts this capacity from the forecast number of surgeries to be expected in the planning area in the target year, and examines the difference to determine:

- a) whether a surplus or shortage of OR's is predicted to exist in the target year, and
- b) if a shortage of OR's is predicted, the shortage of dedicated outpatient and mixed-use rooms are calculated.

In its application of the methodology for dedicated outpatient ORs, the department relied on the most recent data available at the time of the review for all providers in the county--specifically year 2004 data. For consistency, using 2004 data for the hospital's mixed-use rooms is also reasonable.

3) **Exclusion of CN exempt ORs in Kitsap County when counting capacity in the county.**

OASC

OASC asserts that the exclusion of CN exempt ORs when calculating existing capacity to determine need is contrary to the plain language of the rule under WAC 246-310-280.

SCS, LLC

SCS, LLC disagrees with OASC's conclusion regarding the treatment of CN exempt ORs in the capacity count.

DEPARTMENT'S RECONSIDERATION EVALUATION

This issue has been the subject of debate within the adjudicative setting related to previous applications. On November 9, 2006, the Health Law Judge provided the following ruling. [source: Docket #03-06-C-2001CN, November 9, 2006, Findings of Fact, Conclusions of Law, and Final Order on Remand, sections 1.11 and 1.12]

“The number of anticipated future surgeries can be calculated by applying the use rate to the anticipated future population. Determining whether an individual will obtain that future surgery in an ambulatory surgical center (an exempt facility) or an ambulatory surgical facility (a non-exempt facility) cannot be reduced to a mathematical formula. The first concept (anticipated future surgeries) is a numerical value. The second concept (the location of the future surgery) cannot be determined with mathematical certainty. For example, a patient who may qualify for surgery at an exempt ambulatory surgical center in the present may not qualify for surgery in the future at the same exempt facility. Another example is a surgeon who holds surgical privileges at an exempt ambulatory surgical center in the present, may not hold surgical privileges at the same facility in the future. Finally, the exempt ambulatory surgical center may no longer exist. ...What does this mean for calculating the need methodology? It means capturing all current surgical capacity statistics from ambulatory surgical facilities (non-exempt facilities) and ambulatory surgical centers (exempt facilities) in calculating existing capacity, but calculating future need considering only ambulatory surgical facilities [non-exempt facilities] to ensure that the patients have access to surgical facilities in the future.”

Given the ruling above, the department concludes that its approach of excluding CN exempt ORs (ambulatory surgical centers)⁶ when calculating existing capacity is not only consistent with the language of the rule under WAC 246-310-280, it is also consistent with the HLJ ruling restated above.

- **The department failed to follow its own decision to exclude certain information related to HealthSouth from consideration** [source: OASC, August 4, 2006, reconsideration request, pp9-10]

OASC

On May 19, 2006, CN staff sent a letter to the applicant, affected persons, and interested persons informing them of documents that were provided during the course of rebuttal that did not qualify as rebuttal documents and, therefore would not be considered. OASC states that the initial July 7, 2006, evaluation cites to portions of the documents that the staff analyst previously stated it would not consider. OASC states that reconsideration would provide the CN program with an opportunity to correct this error and do what it said it would do: exclude the information related to HealthSouth from consideration in the review. OASC also asserts that it did not have an opportunity to comment on the

⁶ It is noted that WAC 246-310-010 provides the definition of the CN exempt facility within the “ambulatory care facility” definition; while the HLJ references the exempt facility as an “ambulatory surgical center.”

HealthSouth data and would have commented on the data, had it known the information would be used in the evaluation.

SCS, LLC

SCS, LLC disagrees with OASC regarding this issue. In its public hearing and rebuttal documents, SCS, LLC points out that a portion of the documents OASC questions above were attached to OASC's reconsideration request, thus, making the documents part of the record for this reconsideration process. Additionally, SCS, LLC states that this reconsideration process would allow OASC its opportunity to respond to the financial issues experienced by OASC's parent corporation--HealthSouth. [source: October 25, 2006, public hearing documents, pp8-9]

DEPARTMENT'S RECONSIDERATION EVALUATION

Before addressing this issue, the department will provide the following background information:

After the public comment phase of the initial evaluation, WAC 246-310-160(1)(a) allows an applicant and affected person(s) to provide rebuttal statements to any written or oral statements submitted during the public comment period. The rebuttal statements are limited to any documents or statements made within the public comment period. In other words, the rebuttal documents should not bring up any new issues. For the initial review of this project, the applicant--SCS, LLC--included certain documents in its rebuttal documents that were determined by CN staff to be outside the scope of rebuttal. As a result, on May 19, 2006, CN staff sent a letter to the applicant and affected person(s) identifying the specific documents provided within SCS, LLC's rebuttal documents considered to be outside the scope of rebuttal and, thus, would not be considered.

Within its reconsideration request, OASC concludes that CN staff used information within SCS, LLC's rebuttal documents, even though it had already deemed these documents to be outside the scope of review. OASC's cites the rationale for this conclusion is based on a quote provided within the evaluation, which is, according to OASC, the same quote provided in the SCS, LLC documents deemed to be outside the scope of rebuttal. Finally, OASC concludes that the evaluation of HealthSouth's financial status is irrelevant to the review, given that OASC is "*at best, only an affected party of this application.*"

During the course of drafting the evaluation/recommendation for this project, the CN staff reviewed all comments provided by the applicant, affected, and interested persons--excluding those deemed to be outside the scope of review. Comments reviewed include SCS, LLC's specific statements and documents to support its assertion that the existing provider and affected person--OASC--is not available and accessible to meet the needs of the community. Additionally, OASC provided specific statements and documents to support its assertion that it is available and accessible to meet the needs of the community. It is customary practice for CN staff to review any available public data obtained from the internet or other sources to verify assertions made during a review. For this project, CN staff began by reviewing data obtained from its own database regarding the ownership of OASC. OASC is owned by HealthSouth. It is common knowledge

within the healthcare industry that HealthSouth has been the subject of a variety of regulatory actions, lawsuits, and other events that have had an immediate and substantial impact on HealthSouth's financial stability, operations, and cash flows. CN staff reviewed specific documents as they related to the financial stability of OASC's parent company--HealthSouth--such as, financial data obtained through the United States Security and Exchange Commission for years 2003 through 2005. Within its 2005 financial statement, HealthSouth provided the following statements. [source: United States Securities and Exchange Commission, year 2005, page numbers where noted]

"We are highly leveraged. As a consequence, a substantial down-turn in earning could jeopardize our ability to make our interest payment and could impair our ability to obtain additional financing, if necessary. Current and prospective investors, patients, physician partners, and employees may react adversely to the continuing negative effects of the March 2003 crisis and the financial reporting and operational issues that were uncovered as a result of that crisis." [pp38 & 40]

It is critical to note that the quotes above are NOT a conclusion made by CN staff; rather, they are direct quotes by representatives of HealthSouth--OASC's parent company. Below is a restatement of the conclusion reached by CN staff within the initial evaluation. [source: July 7, 2006, Initial evaluation, p10]

"As stated above, HealthSouth acknowledges that the March 2003 financial reporting and operational issues may impact its ability to recruit and retain physicians, investors, patients, and employees. This appears to be occurring in Kitsap County, whereby Kitsap County physicians are unwilling to align with the HealthSouth organization. [source: SCS, LLC May 4, 2006, rebuttal documents, pp61-62] This is evidenced by data provided in the application and HealthSouth's acknowledgement of difficulties with recruitment and retention efforts."

As noted by the statement above, CN staff is merely agreeing with HealthSouth's own statements, and acknowledging that the results of the regulatory actions, lawsuits, and other events regarding HealthSouth are occurring in Kitsap County, and the issues are verified within data provided by OASC during the course of review of the SCS, LLC application.

Regarding OASC's claim that CN staff used data deemed to be outside the scope of review because the quotations are the same, CN staff can only reiterate its position that the data submitted by SCS, LLC was not used. Rather, the information reviewed was independently gathered during the CN staff's verification process of statements made during the course of the review.

OASC's position is HealthSouth's financial status is irrelevant to the review, given that OASC is an affected person, not the applicant; as a result, OASC asserts that HealthSouth's financial status should not even be considered in this review. The department is aware that SCS, LLC, is the applicant; not OASC, or its parent corporation, HealthSouth. However, during the course of this review, OASC asserted that it is available and accessible to the residents of the service area. Further, OASC provided documents to demonstrate a low utilization at the ASC and that it had space and OR time

available for any doctors associated with SCS, LLC that may be interested in performing surgeries at OASC, rather than establishing another facility.

However, during the course of review of the SCS, LLC application, OASC never provided any information to explain its low utilization of the ASC, or its 49.4% decrease in utilization of the ASC from year 2004 to 2005, or why local physicians do not request OR time at OASC. All of those issues are addressed in HealthSouth's financial documents restated above and acknowledged by HealthSouth to be a result of its regulatory actions, lawsuits, and other events. A review of HealthSouth's financial documents identified in the initial evaluation was imperative to determine whether the existing provider--OASC--is, in fact, available and accessible to meet the needs of the community.

As previously stated, after reviewing the information provided in HealthSouth's historical financial documents, CN staff simply agreed with HealthSouth's own statements, and acknowledged that the identified results of the regulatory actions, lawsuits, and other events regarding HealthSouth are occurring in OASC located in Kitsap County.

- **Significant relevant information was not previously considered by the department**
[source: OASC, August 4, 2006, reconsideration request, pp11-14]

OASC asserts there are two specific factors that were not previously considered by the department in the initial evaluation. The two factors are: 1) recent positive developments identified in HealthSouth's financial documents that were not considered; and 2) Inventory of existing mixed use and dedicated outpatient ORs in Kitsap County. SCS, LLC also submitted comments regarding the two factors.

1) **Recent positive developments identified in HealthSouth's financial documents that were not considered**

OASC

OASC states that if the program is going to consider HealthSouth information, then it should have considered the context of the statements taken from HealthSouth's 10-K and other information about HealthSouth. OASC cites some examples of positive developments that the program should have considered, including reconstruction of financial statements, prepayment of debt and recapitalization, and several settlements in various legal matters. OASC further states that the paragraph after its quoted "*We are highly leveraged*" statement cited in the initial evaluation was misleading. OASC asserts that additional information in HealthSouth's financial documents contradicts the conclusions reached in the initial evaluation regarding HealthSouth.

SCS, LLC

SCS, LLC states that despite OASC's assertions, HealthSouth's financial condition remains questionable. To demonstrate its position, SCS, LLC, provided a copy of an announcement entitled "HealthSouth Announces Repositioning to Focus on Inpatient Rehabilitation, Creating Pure-Play Investment in Post Acute Care." SCS,

LLC points out that the article states that HealthSouth intends to sell its ASCs to assist in accelerating its debt repayment. [source: October 25, 2006, public hearing documents, Exhibit B]

Additionally, SCS, LLC notes that the regulatory actions taken against HealthSouth were not merely related to overpayment issues. SCS, LLC further states that HealthSouth places a cloud over OASC due to HealthSouth's past acts. Physicians do not want to be involved with a healthcare entity that has had regulatory sanctions and continues to be under the scrutiny of state and federal regulators. [source: October 25, 2006, public hearing documents, pp9-10]

DEPARTMENT'S RECONSIDERATION EVALUATION

While it appears that HealthSouth is and continues to work toward improving its financial stability, at this time, HealthSouth is not viewed by physicians and patients as being financially stable. Regarding the sale of OASC, HealthSouth representatives assert that *"the sale of its surgical division (ASCs) is not evidence that OASC will not continue to exist and operate and thus be available to serve Kitsap County physicians and residents."* While this assertion may be true, HealthSouth's announcement of its sale of the ASCs certainly cannot be viewed as assurance that the ASC would continue to exist. There is no way to predict what decisions a new owner may make regarding OASC.

HealthSouth anticipates sale of its ASCs and two other divisions by the first or second quarter of 2007. At that time, the new owners can decide the future of OASC. In the meantime, it continues to be appropriate to count the two ORs in operation at OASC in its numeric methodology.

A second review of the financial documents provided by OASC in its reconsideration request does not alter the department's initial conclusion regarding OASC's parent company, HealthSouth. HealthSouth acknowledges in its March 2005 financial documents that its 2003 regulatory actions, lawsuits, and other events may impact its ability to recruit and retain physicians, investors, patients, and employees. The department concludes that this appears to be occurring in Kitsap County, whereby Kitsap County physicians are unwilling to align with the HealthSouth organization. This is further evidenced by data provided in the application and HealthSouth's acknowledgement of difficulties with recruitment and retention efforts.

2) Inventory of existing mixed use and dedicated outpatient ORs in Kitsap County.

This issue was already addressed under OASC's rationale that the department failed to follow established procedures when calculating numeric need for the project. The department concluded that the correct count of mixed use ORs at Harrison Medical Center is 10. This is the number used by the department when applying the numeric methodology.

- **Other Good Cause Exists to Warrant Reconsideration** [source: OASC, August 3, 2006, reconsideration request, pp15-18]

OASC

The “other causes” identified by OASC are: 1) HMC submitted questionable data to the department in its survey responses; and 2) The department failed to consider the financial strength of HMC, one of the applicants. SCS, LLC also submitted comments regarding the two factors.

The issue identified by OASC in #1 above has been addressed. Regarding the financial strength of HMC, OASC asserts that HMC is also highly leveraged; perhaps more so than HealthSouth. OASC also reviewed historical 2002-2004 financial statements for HMC and concludes that HMC’s increase in bad debt is at a rate of three times its total revenue and is a significant economic warning signal for the hospital.

SCS, LLC

SCS, LLC states that OASC fails to acknowledge that the applicant for this project is SCS, LLC, not HMC or Kitsap Outpatient Surgery, therefore, the conclusion reached by the program that the applicant--SCS, LLC--had obtained the required financing and otherwise demonstrated that the financial feasibility criterion remains correct. [source: October 25, 2006, public hearing documents, pp15-16]

DEPARTMENT’S RECONSIDERATION EVALUATION

For this issue, both OASC and SCS, LLC are partially correct. OASC is correct in that HMC is 30% owner of SCS, LLC, and as a result, is subject to a financial history review as it relates to this project.⁷ SCS, LLC is also correct that the applicant is SCS, LLC--not HMC or Kitsap Outpatient Surgery. However, both HMC and Kitsap Outpatient Surgery make up the entity known as SCS, LLC. While SCS, LLC must obtain the funding for the project, the funding will be based on the names, reputations, and financial solvency of both HMC and the physicians that make up Kitsap Outpatient Surgery.

OASC is incorrect, however, in its assertion that a financial review was not performed for HMC. On the contrary, HMC’s financial documents were reviewed and cited on pages 14 and 15 of the initial evaluation. Additionally, any data provided by the applicant regarding HMC was verified by the program by reviewing the hospital’s financial data submitted to the department’s Office of Hospital and Patient Data Systems.

In summary, all of the reconsideration issues raised by OASC have been addressed. Both OASC and SCS, LLC, identified an error in the mathematical computation of the methodology. Specifically, the department calculated the HMC’s average surgery minutes by dividing 2005 outpatient surgery minutes by its 2004 count of outpatient surgeries. Appendix A attached to this reconsideration evaluation corrects that error.

⁷ Additionally, with its 30% ownership, HMC is subject to the quality of care review which was performed in the initial evaluation.

To support its July 7, 2006, initial evaluation, the department applied the numeric methodology using the following OR capacity in the county--6 dedicated outpatient ORs and 10 mixed use ORs. The 6 dedicated outpatient ORs include the 2 operational ORs identified by OASC.⁸ This is the OR count the department relied on in its initial review. Additionally, attached to the initial evaluation is application of the numeric methodology using 8 dedicated outpatient ORs 10 mixed used ORs. The 8 dedicated outpatient ORs included OASC's 2 ORs identified by them to be "*closed and not in use.*" The department did not address the results of this methodology in the initial evaluation. Based on documents provided in the application, OASC's initial utilization survey responses, and data obtained from the department's own database, the department concludes that the correct number of dedicated outpatient ORs in the county is 6.

In the initial evaluation, the department's application of the numeric methodology using survey responses indicated a surplus of 3 inpatient ORs (rounded from 3.12) and a need of 6 outpatient ORs (rounded from 6.48) for the Kitsap planning area in year 2010.

For this reconsideration evaluation, the department once again applied the numeric methodology twice using both numbers of dedicated outpatient ORs. Additionally, the department corrected the numeric methodology error identified by both OASC and SCS, LLC. The correction includes dividing the year 2004 outpatient surgery minutes by 2004 count of outpatient surgeries. Using 6 dedicated outpatient ORs and 10 mixed use ORs, the corrected methodology--included as Attachment A to this evaluation--results in a surplus of 3 inpatient ORs (rounded from 3.12) and a need of 6 dedicated outpatient ORs (rounded from 6.41) for the Kitsap planning area in year 2010. Applying the same methodology using 8 dedicated outpatient ORs and 10 mixed use ORs, results in a surplus of 3 inpatient ORs (rounded from 3.12) and a need for 4 dedicated outpatient ORs (rounded from 4.41) for year 2010.

In conclusion, as shown in Appendix A, correction of the numeric methodology error does not significantly affect the outcome of numeric methodology or the numeric need evaluation for this project. Additionally, whether counting 6 dedicated outpatient ORs or 8 dedicated outpatient ORs in the county, numeric need for additional OR capacity in Kitsap County is demonstrated.

- (2) All residents of the service area, including low-income persons, racial and ethnic minorities, women, handicapped persons, and other underserved groups and the elderly are likely to have adequate access to the proposed health service or services.

In its July 7, 2006, initial evaluation, the department concluded that all residents of the service area including low-income, racial and ethnic minorities, handicapped and other underserved groups would have access to services at SCS, LLC's ASC.. The department further noted that a condition was necessary to ensure that the proposed ASC would meet or exceed the charity care percentages provided by the hospitals within the Puget Sound Region and HMC. On July 14, 2006, the department issued CN #1334 for this project. There was no additional information provided during the reconsideration review that would change this conclusion by the department, therefore, this sub-criterion remains met.

⁸ The remaining 4 ORs are broken down between Harrison Medical Center (1) and North Kitsap ASC (3).

B. Financial Feasibility (WAC 246-310-220)

Based on the source information reviewed, the department determines that the applicant has met the financial feasibility criteria in WAC 246-310-220.

- (1) The immediate and long-range capital and operating costs of the project can be met.
- (2) The costs of the project, including any construction costs, will probably not result in an unreasonable impact on the costs and charges for health services.
- (3) The project can be appropriately financed.

In its July 7, 2006, initial evaluation, the department concluded that the project met the financial feasibility criteria outlined in WAC 246-310-220. In the need portion of this reconsideration evaluation, the department continues to conclude that the need criteria is met. There was no additional information provided during the reconsideration review that would change the department's conclusion regarding the financial feasibility criteria; therefore, these sub-criteria remain met.

C. Structure and Process (Quality) of Care (WAC 246-310-230)

Based on the source information reviewed, the department determines that the applicant has met the structure and process (quality) of care criteria in WAC 246-310-230.

- (1) A sufficient supply of qualified staff for the project, including both health personnel and management personnel, are available or can be recruited.
- (2) The proposed service(s) will have an appropriate relationship, including organizational relationship, to ancillary and support services, and ancillary and support services will be sufficient to support any health services included in the proposed project.
- (3) There is reasonable assurance that the project will be in conformance with applicable state licensing requirements and, if the applicant is or plans to be certified under the Medicaid or Medicare program, with the applicable conditions of participation related to those programs.
- (4) The proposed project will promote continuity in the provision of health care, not result in an unwarranted fragmentation of services, and have an appropriate relationship to the service area's existing health care system.
- (5) There is reasonable assurance that the services to be provided through the proposed project will be provided in a manner that ensures safe and adequate care to the public to be served and in accord with applicable federal and state laws, rules, and regulations.

In its July 7, 2006, initial evaluation, the department concluded that the project met the structure and process of care criteria outlined in WAC 246-310-230. In the need portion of this reconsideration evaluation, the department continues to conclude that the need criteria is met. There was no additional information provided during the reconsideration review that would change the department's conclusion regarding the structure and process of care criteria; therefore, these sub-criteria remain met.

D. Cost Containment (WAC 246-310-240)

Based on the source information reviewed, the department determines that the applicant has met the cost containment criteria in WAC 246-310-240.

(1) Superior alternatives, in terms of cost, efficiency, or effectiveness, are not available or practicable.

In its July 7, 2006, initial evaluation, the department concluded that the project met the structure and process of care criteria outlined in WAC 246-310-240. In the need portion of this reconsideration evaluation, the department continues to conclude that the need criteria is met. There was no additional information provided during the reconsideration review that would change the department's conclusion regarding the cost containment criteria; therefore, this sub-criterion remains met.

APPENDIX

A